

**PUBLIC
REBUTTAL TESTIMONY**

of

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Policy Group

**Energy Division
Illinois Commerce Commission**

**Charmar Water Company
Proposed General Increase in Water Rates**

**Cherry Hill Water Company
Proposed General Increase in Water Rates**

**Clarendon Water Company
Proposed General Increase in Water Rates**

**Ferson Creek Utilities Company
Proposed General Increase in Water and Sewer Rates**

**Harbor Ridge Utilities, Inc.
Proposed General Increase in Water and Sewer Rates**

**Killarney Water Company
Proposed General Increase in Water Rates**

Docket Nos. 11-0561/0562/0563/0564/0565/0566 (Cons.)

**December 15, 2011
Confidential Information is Denoted as XXX**

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1 **I. Witness Qualifications**

2 **Q. State your name and business address.**

3 A. My name is David Sackett and my business address is 527 East Capitol Avenue,
4 Springfield, Illinois 62701.

5
6 **Q. By whom are you employed and in what capacity?**

7 A. I am employed as an Economic Analyst in the Policy Program of the Energy
8 Division of the Illinois Commerce Commission ("Commission" or "ICC").

9
10 **Q. What are your responsibilities within the Energy Division – Policy**
11 **Program?**

12 A. I provide economic analysis and advise the Commission and other Staff
13 members on issues involving the natural gas and electric utility industries. I
14 review tariff filings and make recommendations to the Commission concerning
15 those filings. I provide testimony in Commission proceedings. In selected cases,
16 I may be called upon to act as an assistant to Commissioners or to administrative
17 law judges.

18
19 **Q. State your educational background.**

20 A. I graduated from Kankakee Community College with an Associate of Science
21 degree in Arts and Sciences in 1998. I graduated with highest honors from
22 Illinois State University with a Bachelor of Science degree in Economics and
23 History in 2000. I obtained a Master of Science degree in Applied Economics

from Illinois State University in the Electric, Natural Gas and Telecommunications Economics sequence¹ in 2002. I also completed an internship at the Commission in the Energy Division in 2001.

Q. Describe your professional experience.

A. Since July 2007, I have been an Economic Analyst in the Policy Program of the Commission's Energy Division. During that time I have participated in several docketed proceedings before the Commission. I have often filed testimony that considered the transportation tariffs of gas Local Distribution Companies ("LDC"). Most recently, I filed testimony in Nicor Gas Company's Operating Agreement docket (Docket No. 09-0301 consolidated with Docket No. 11-0046, in which Nicor Gas Company seeks approval of its reorganization) and Docket Nos. 11-0280 and 11-0281 (Cons.) (North Shore Gas Company and The Peoples Gas Light and Coke Company rate proceedings). This most recent testimony has addressed affiliate interaction and warranty products.

Prior to joining the Commission, I was an instructor at Illinois State University from 2003 to 2006, where I taught various courses in economics and statistics to undergraduate students. I am a Captain in the Marine Corps Reserve having served since 1993; I have completed two deployments to Iraq.

¹ "The Electricity, Natural Gas, and Telecommunications Sequence is a structured program that combines training in basic economic theory and statistical methods with specialized training in the theory, history and institutions of the economics of regulation." ISU website: <http://www.econ.ilstu.edu/grad/program.htm>.

II. Purpose of Testimony and Background Information

Q. What is the subject matter of your rebuttal testimony?

A. The purpose of my testimony is to present Staff's adjustments to Statements of Operating Income for Charmar Water Company ("Charmar"), Cherry Hill Water Company ("Cherry Hill"), Clarendon Water Company ("Clarendon"), Ferson Creek Utilities Company ("Ferson Creek"), Harbor Ridge Utilities, Inc. ("Harbor Ridge"), and Killarney Water Company ("Killarney") (individually, the "Company" and collectively, the "Companies"). My testimony focuses on services that the Companies provide for their affiliate, the absence of Commission approval to provide these services, and the lack of any compensation for those services. Specifically, I respond to the Companies witness Lena Georgiev. (Co. Ex. 3.0, p. 6.)

Q. Why are you testifying in this docket since you typically testify in gas and electric cases?

A. The adjustments that I am proposing address the provision of utility customer information by an affiliate of the Companies. I have testified on similar affiliate issues as described above.

Q. Do you have any attachments to your testimony?

A. Yes. I have attached the following documents to my rebuttal testimony. Attachment A is the Marketing Agreement between Water Services Corporation and HomeServeUSA which was provided in response to Staff Data Request

67 (“DR”) DLH 12.01. Attachment B is the Affiliated Interest Agreement between
68 Water Services Corporation and the Companies² which was provided in
69 response to Staff DR DLH 4.01.
70

71 **III. Summary of Conclusions and Recommendations**

72 **Q. Please summarize your conclusions and recommendations.**

73 A. I have four specific recommendations for the Commission in this docket, as
74 follows:

- 75 1. Find the Companies in violation of the Public Utilities Act for allowing their
76 affiliate to provide services under an agreement not approved by the
77 Commission;
- 78 2. Impose a reasonable penalty on the Companies for violating the Public Utilities
79 Act;
- 80 3. Investigate the AIA of each Utilities, Inc. (“UI”) Illinois utilities to ensure that they
81 are in the public interest given the lack of customer protections; and
- 82 4. If the Commission does not impose reasonable penalties on the Companies, I
83 recommend as an alternative that it adjust the Miscellaneous Revenues portion
84 of each Company’s revenue requirement down by its proportion of the
85 annualized amount of UI’s Illinois utilities net commissions as listed below.
86

² Both WSC and the Companies are Subsidiaries of Utilities, Inc. (“UI”). (Co. Ex. 1.0, p. 2)

IV. Affiliated Interests and HomeServeUSA

A. Introduction and overview of HomeServeUSA warranty products

Q. How was an issue regarding the Companies' affiliates interactions with HomeServeUSA raised?

A. Staff witness Dianna Hathhorn raised an issue in her direct testimony regarding the Companies' affiliate and its interaction with HomeServeUSA ("HS"). Ms. Hathhorn describes a contract between the Companies' affiliated services company, Water Services Corporation ("WSC") and HS. (Staff Ex. 1.0, p. 25) This confidential contract is called a Marketing Agreement ("MA"). The MA is attached to my rebuttal testimony as Attachment A.

Q. Does WSC receive compensation from HS?

A. Yes. Ms. Hathhorn notes that "WSC receives compensation based upon the Companies' ratepayers enrolling in HomeServeUSA's plans. However, no such compensation has been included in the Companies' proposed revenue requirements in this case to offset rates." (Staff Ex. 1.0, p. 25)

Q. What did Staff witness Hathhorn propose regarding the Companies' affiliates' interactions with HS?

A. Ms. Hathhorn recommended "that the Companies provide the amount of other revenue adjustments on this issue in their rebuttal testimony. The adjustments should reflect the on-going amount of revenues related to each Company's ratepayer's participation in HomeServeUSA contracts." (Staff Ex. 1.0, p. 25)

111 **Q. How did the Companies respond to this issue?**

112 A. The Companies did not deny that WSC receives compensation from HS. They also
113 failed to provide the adjustments as requested. Their witness Ms. Georgiev states,
114 “The revenues collected and booked by the parent company, Utilities Inc., are non-
115 utility in nature. Those non-utility revenues are not included in the Companies’
116 revenue requirement for rate making purposes. No expenses associated with the
117 activity have been included in the Companies [sic] revenue requirements.” (Co Ex.
118 3.0, p. 6)

119

120 **Q. Does the MA require WSC to provide customer information to HS?**

121 A. XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX.

122 XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

123 XX (MA section 9.1, p. 7)

124

125 **Q. Does the MA set forth the compensation from HS to WSC for providing**
126 **customer information to HS?**

127 A. Yes. XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

128 XXXXX. (Attachment A, p. 5) XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

129 XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

130 XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX. (Id., p. 2)

131

132 **Q. Is there a document that governs the transactions between WSC and the**
133 **Companies?**

134 A. Yes. The Companies each have an identical agreement with WSC that sets forth
135 the services that WSC performs for each Company. This Affiliated Interest
136 Agreement (“AIA”) states that WSC provides billing and customer relations.
137 (Attachment B, p. 2) It also sets forth the cost that the Companies pay to WSC for
138 the services rendered. (*Id.*, pp. 3-4) Significantly, the AIA is a one-way agreement
139 as it does not allow the Companies to provide any services to WSC and does not
140 provide any basis for WSC to pay the Companies.

141

142 **B. Water Services Corporation is not authorized to provide customer**
143 **data to HomeServeUSA**

144 **1. The provision of customer lists and customer-related information is a**
145 **service.**

146 **Q. Do the Companies acknowledge that the provision of customer information**
147 **to WSC is a service when they use that information to increase shareholder**
148 **revenues?**

149 A. No. According to the Companies’ response to Staff DR DLH 16-13, they do not
150 provide any services to WSC or Utilities, Inc., their holding company.

151

152 **Q. Do the Companies acknowledge that its interactions with WSC are subject to**
153 **Commission approval?**

154 A. Partially. The Companies acknowledged that “contracts with or arrangements for
155 the furnishing of any service by WSC are within the jurisdiction of the
156 Commission under the provisions of Section 7-101 of the Act.” (Companies’
157 Petition, Docket No. 08-0335) The Act’s requirement applies equally to services
158 provided by a utility to its affiliate.

159 **Q. Do the Companies perform a service for WSC?**

160 A. Yes. The “provision of customer list and other customer-related information” is a
161 service that the Companies provide for WSC. Other utilities and the
162 Commission have recognized it as such.

163

164 **Q. Where have other utilities recognized that this constitutes a service?**

165 A. This concept first appeared in Nicor Gas’ proposed Operating Agreement³ in
166 Docket No. 00-0537; subsequently, Peoples Gas and North Shore proposed this
167 concept as a service to the Commission in Docket No. 06-0540

168

169 **Q. Where has the Commission recognized that this constitutes a service?**

170 A. The Commission has recognized that the provision of “customer lists and other
171 customer-related information” is a service when it approved these two
172 agreements. Since the Commission has determined that this is a service it must,
173 by law, be approved and if approved, the Companies must be compensated by
174 their affiliate for it.

175

176 **2. Not expressly authorized by the Affiliated Interest Agreement**
177 **Q. Does the AIA authorize WSC to sell “customer information” to HS?**

³ The Operating Agreement is essentially a two-way affiliated interest agreement that allows the utility to provide services for the affiliate with compensation. (Docket No. 00-0537)

178 A. No. WSC retains customer information as part of its duties as the customer service
179 provider for the Companies. (Attachment B, pp. 2-3) The AIA does not authorize
180 any passage of ratepayer information to any third party.

181

182 **Q. May a Company provide services for it affiliate without specific**
183 **Commission authorization?**

184 A. No. Utilities are precluded by Section 7-101 of the Public Utilities Act ("Act") from
185 interacting with their affiliates except through agreements approved by the
186 Commission. These agreements must be in the public interest. (220 ILCS 5/7-
187 101.)

188

189 **Q. When the Commission approved this service for other utilities, did it place**
190 **other significant restrictions on the use of this information?**

191 A. Yes. In each of these cases, the Commission approved the service, but never
192 without a mechanism that required the affiliate to pay the utility the market value
193 or fully distributed cost of this service. Furthermore, the Commission has also
194 approved a clause in these agreements that protects the information provided as
195 confidential. Nicor Gas has an article that would prevent its affiliate from selling
196 its data to a third-party.⁴ (Exhibit A to Petition, Docket No. 00-0537, pp. 10-11)

⁴ ARTICLE VIII Confidential Information

Each Party shall treat in confidence all information which it shall have obtained regarding the other Parties and their respective businesses during the course of the performance of this Agreement. Such information shall not be communicated to any person other than the Parties to this Agreement, except to the extent disclosure of such information is required by a governmental authority. If a Party is required to

197 Peoples Gas and North Shore also have identical requirements. (Applicants' Ex.
198 No. LK 1.2, Docket No. 06-0540, p. 11) Such an article is missing from the AIA
199 here.

200

201 **Q. Do the Companies' actions indicate an acceptance that "customer lists and**
202 **other customer related information" are a service.**

203 A. No. The Companies do not view the provision of "customer lists and other
204 customer related information" as a service, have not requested the Commission
205 to approve it, nor have they included any mechanism to compensate the
206 Companies for this service.

207

208 **Q. Can the Companies determine what constitutes a service?**

209 A. No, the Companies are not at liberty to make this determination. Rather, the Act
210 requires the Commission to be the arbitrator here. The "provision of customer list
211 and other customer-related information" service that the Companies provide for
212 WSC may be costless (or those costs may be recovered from HS) but it is not a
213 *valueless* service. Consequently, it is a service, and it is not authorized in the

disclose confidential information to a governmental authority, such Party shall take reasonable steps to make such disclosure confidential under the rules of such governmental authority. Information provided hereunder shall remain the sole property of the Party providing such information. The obligation of a Party to treat such information in confidence shall not apply to any information which (i) is or becomes available to such Party from a source other than the Party providing such information, or (ii) is or becomes available to the public other than as a result of disclosure by such Party or its agents. (Exhibit A to Petition, Docket No. 00-0537, pp. 10-11)

only Commission-approved agreement, the AIA. The Commission has not granted approval for the Companies to perform any service for WSC or any other affiliate.

3. May Violate Various Privacy Policies

Q. Do any of the Companies or their affiliates have privacy policies?

A. Yes. XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX (Attachment A, p. 8) Staff has requested the Companies to provide the privacy policies of each Company as well as those of UI, HS and WSC. At this point, those policies have not been provided. However, if those policies are written to protect the confidentiality of ratepayer information, then WSC's release of this information may well violate those policies.

C. Ratepayers should be the beneficiaries, not the affiliate.

1. Utility Information

Q. Is the information provided to HS by WSC utility information?

A. Yes. The confidential customer information provided by WSC to HS is utility information, not affiliate information. Ratepayers provide this information to each Company when they sign up for utility service, and WSC maintains this information as part of its duties in providing customer service on behalf of each Company. (Attachment B, pp. 2-3)

2. Utility Service

Q. Is the Billing and Customer Relations service provided by WSC for each Company a Utility Service?

239 A. Yes. The Billing and Customer Relations service that WSC performs on behalf of
240 each Company is utility in nature and thus, the associated expenditures for these
241 services are recovered from ratepayers. (Co Ex. 1.0, p. 2)
242

243 **Q. Is the Customer Information service provided by WSC to HS a utility**
244 **service?**

245 A. Not according to the Companies' rebuttal testimony. According to Ms. Georgiev,
246 the revenues are non-utility in nature. (Co Ex. 3.0, p. 6) Therefore, the Companies
247 appear to believe that the Customer Information service that WSC provides to HS
248 to be non-utility in nature. However, as noted above, the Commission has
249 historically treated the provision of customer lists and customer-related information
250 as a service.
251

252 **3. Should Be Utility Revenue**
253 **Q. Does WSC have an agreement with UI that provides for an allocation of**
254 **these revenues back to UI or any utility?**

255 A. No. The Companies responses to Staff DRs DLH 16.05 and DLH 16.06 state that
256 no such documents exist. Therefore, no mechanism is in place to allow UI to credit
257 these revenues back to its subsidiaries. If there is no mechanism to credit these
258 revenues back to the Companies, then the shareholders receive unjustified profits
259 in excess of the rate of return.
260

261 **Q. How should those revenues be reflected in this case?**

262 A. A utility should not be able to profit from its position and leverage its customers for
263 profit unless those efforts offset the costs of providing utility service. If the use of
264 utility information for non-utility purposes results in revenues, those revenues
265 should offset the cost of service to ratepayers. Since there is no mechanism to
266 credit these revenues back to the Companies, the only option is to credit these to
267 ratepayers in a rate case such as this.

268

269 **4. Commission Recently Ruled That Ratepayers Should Not Subsidize**
270 **Shareholders**

271 **Q. Has the Commission ever ruled on issues of affiliate interactions and**
272 **customer subsidization of shareholders?**

273 A. Yes. In its recent decision in Docket No. 11-0046, the Commission ordered Nicor
274 Gas to stop soliciting on behalf of its affiliates. The Commission ruled that Nicor
275 Gas was subsidizing its affiliate because the value of its solicitation services was
276 accruing to shareholders, not ratepayers. "The Commission concludes here that
277 the right to market NS [Nicor Services] services to customers during utility business
278 calls has commercial value that exceeds NG's [Nicor Gas'] mere costs, and the
279 transfer of that value without compensation constitutes a subsidy for NS." (Order,
280 Docket No. 11-0046, December 7, 2011, p. 55)

281

282 **Q. Is this situation here similar?**

283 A. Yes. Because the revenues are not credited back to the Companies by WSC, the
284 value of the "customer information" service to HS accrues to shareholders instead
285 of the ratepayers. Thus, ratepayers are subsidizing shareholders.

286

287 **D. Conclusions and recommendations**

288 **1. Commission Should Find that the Companies Violated Section 7-101 of the**
289 **Public Utilities Act**

290 **Q. How would you propose the Commission deal with the Companies actions**
291 **with respect to Consumer Information?**

292 A. I recommend that the Commission make a finding that the Companies violated
293 Section 7-101 of the Act by providing a service to their affiliate without
294 authorization.

295

296 **2. Commission Should Consider a Fine for the Violation of the Public Utilities**
297 **Act**
298

299 **Q. Do you recommend any further action as a result of this violation of the**
300 **Act.**

301 A. Yes. I recommend that each Company in this consolidated proceeding be
302 assessed a fine under Section 5-202 of the Act. In addition, I recommend that
303 the Commission investigate the other Utilities, Inc. companies in Illinois to
304 determine whether they should be assessed similar fines.

305

306 **Q. What is the range of fines possible under the Act?**

307 A. Since the Companies are "small utilities" according to the Act, the fine is limited
308 to the range of \$500 to \$2000 per occurrence.

309

310 **Q. How much of a fine do you recommend?**

311 A. I recommend that this fine be greater than or equal to the amount that UI
312 receives from HS via WSC for the initial provision of information. I calculate that
313 amount to be about \$20,000.⁵ Therefore, I recommend the fines be set at \$1000
314 per utility in this case. If the Commission were to initiate an investigation into the
315 18 other UI utilities that are subject to Commission jurisdiction, I would also
316 recommend that they also be required to pay a similar amount.

317

318 **3. Prohibit Further Transfer of Confidential Customer Information to any Third**
319 **Party by Modifying the Affiliated Interest Agreement.**

320 **Q. Do you recommend WSC continue to be allowed to provide customer**
321 **information to third parties?**

322 A. No. The Commission should prohibit all future release of customer information.
323 Additionally, the Commission should order each Company to retrieve its customer
324 information from HS by requiring WSC to recover all Illinois ratepayer information
325 from HS per the stipulation in section 9.1 of the MA.

326

327 **Q. What is the basis of this recommendation?**

328 A. This information is acquired based on utility service. Customers are required to
329 give the utility or its designee this information to obtain service from the franchised
330 utility. Without specific authorization by the customer or the Commission, the
331 information should not be distributed to others. If the Commission authorizes such

⁵ The Companies' responses to Staff DR DLH1.01 indicate that UI's Illinois Utilities make up 6.6% of UI's total business. 6.6% of 300,000 equals about \$20,000.

332 information to be passed along, the value of that information must benefit
333 ratepayers.

334

335 **Q. Do you also recommend that the Commission require the Companies to**
336 **change their AIAs?**

337 A. Yes. I recommend that the Commission order each Company to add a clause to
338 its AIA to protect all customer information. That language should read:

339 At no time shall the Service Company be allowed to use the
340 Operating Company's customers' information for any non-utility
341 purpose. This includes but is not limited to provision to any third party
342 including the Parent for any purpose. Additionally, it precludes the
343 Service Company from using this information to provide information
344 about any product or service that is a non-utility product or service to
345 any customer of the Operating Company.
346

347 Executed copies of all such agreements should be filed on the Commission's e-
348 docket system in the instant proceeding.

349

350 **4. Investigation into the Affiliated Interest Agreement**
351 **Q. What do you recommend that the Commission require regarding the AIA**
352 **that all UI utilities in Illinois use?**

353 A. Since the current AIA referenced here is used by all 18 other UI utilities in Illinois, I
354 recommend that the Commission require each UI utility in Illinois to include the
355 above clause in all such agreements. Alternatively, the Commission should open
356 an investigation into all such agreements concerning whether that agreement is still
357 in the public interest given the lack of any customer privacy protections.

358

359 **5. Adjustment to Revenue Requirement**

360 **Q. What do you recommend if, in the alternative, the Commission does not**
361 **choose to require the Companies to cease the provision of this information?**

362 A. In that alternative, I recommend that the Commission approve an adjustment to
363 the Miscellaneous Revenues portion of the revenue requirement for each
364 Company for revenues that they should have received from WSC during the test
365 year.

366

367 **Q. How much of an adjustment would that be?**

368 A. I recommend that these adjustments be equal to the amount of each Company's
369 portion of the revenues that UI receives from HS via WSC. I estimate that the
370 amount of this adjustment is equal to the amount found in Figure 1 – Estimated
371 HomeServe Revenues for Illinois below.

372

373 **Q. What is your estimated annualized revenue that HS receives for all UI**
374 **Illinois utilities?**

375 A. **XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX**
376 **XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX**
377 **XXXXXXXXXXXX.**

378

379 **Q. How much of this amount does WSC receive from HS in a net commission?**

380 A. **XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX**
381 **XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX.**

Q. How much of this amount does WSC receive from HS in a net commission for each of the Companies in this case?

A. Because I do not have a count from the Companies for all warranty products in all UI *Illinois* utilities, I have estimated the amount for each Company in this case based on the allocation factors provided by the Companies in response to Staff DR DLH-1.01 which is the number of accounts.

| Estimated HomeServe Revenues for Illinois | | | | |
|-------------------------------------------|--------|---------------|--------------------|--------------|
| May-11 | XXXXXX | | DLH 13.02 | Confidential |
| Jun-11 | XXXXXX | | DLH 13.02 | Confidential |
| Jul-11 | XXXXXX | | DLH 13.02 | Confidential |
| Quarter | XXXXXX | | | Confidential |
| Annualized | XXXXXX | | | Confidential |
| Percentage | XXXX | | DLH 16.09 | Confidential |
| Net Commission for IL | XXXX | | | Confidential |
| | | IL Factors | | |
| Charmar Water Co | XXXX | XXXX | DLH 1.01 and 13.02 | Confidential |
| Cherry Hill Water Co | XXXXX | XXXX | DLH 1.01 and 13.02 | Confidential |
| Clarendon Water Co | XXXXX | XXXX | DLH 1.01 and 13.02 | Confidential |
| Ferson Creek Utilities Co | XXXXX | XXXX | DLH 1.01 and 13.02 | Confidential |
| Harbor Ridge Utilities Inc | XXXXX | XXXX | DLH 1.01 and 13.02 | Confidential |
| Killarney Water Co | XXXXX | XXXX | DLH 1.01 and 13.02 | Confidential |
| Total | XXXXXX | XXXXX | | Confidential |

Figure 1 – Estimated HomeServe Revenues for Illinois

Q. Does this conclude your prepared rebuttal testimony?

A. Yes.